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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In re the Matter of	)	
	)	MM Docket No. 94-123
Review of the Prime Time Access Rule, Section 73.658(k) of the Commission's Rules	)	

REPLY COMMENTS OF THE COALITION TO ENHANCE DIVERSITY

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List A B C D E

TABLE OF CONTENTS

	Page(s)
SUMMARY AND INTRODUCTION	1
I. PROPONENTS OF THE OFF-NETWORK RESTRICTION HAVE FAILED TO MAKE A CASE FOR ITS RETENTION	5
A. Elimination Of The Off-Network Restriction Will Not Produce The Dire Consequences Predicted By Supporters Of The Restriction	5
1. The Market For First-Run Programming Will Not Be Destroyed When The Off-Network Restriction Is Lifted	5
a. First-Run Syndicated Programming Does Not Have Any Unique Cost Disadvantage When Compared To Off-Network Programming	6
b. First-Run Syndicated Programming Has Many Advantages Over Off-Network Programming	10
c. Because The Cost Structure Of First-Run Syndicators Is A Product Of The Protections Of The Off-Network Restriction, First-Run Syndicators Will Simply Adjust Their Costs To Account For Competition	14
2. First-Run Syndicated Programming Is Not Handicapped By Any Flaws In The Market	15
a. First-Run Syndicated Programming Is Not A Public Good	15
b. The Actual Production Costs For First-Run Syndicated Programs Are Not Unique And Do Not Require Regulation	16
c. The First-Run Syndication Industry Does Not Require Or Warrant Continued Infant Industry Protections	17

Page(s)

3. Independent Stations Will Not Suffer Serious Financial Harm If The Off-Network Restriction Is Lifted 18

a. Independent Stations Will Not Necessarily Pay More For Programming 19

b. Independent Stations Will Not Necessarily Lose Access To Top Quality Off-Network Programs 20

c. Even Assuming That Independent Stations Were Outbid For High Quality Off-Network Programs, Their Financial Loss Would Not Be Significant 22

B. Preservation Of The Off-Network Restriction Is Not Critical To The Development Of Incipient Networks 26

C. The Off-Network Restriction Has Arbitrarily Depressed Prices For Off-Network Programming 28

II. OPPONENTS OF THE NETWORK RESTRICTION HAVE FAILED TO SHOW THAT THERE IS ANY COST THAT OUTWEIGHS ITS CONTINUED BENEFITS 29

A. The Network Restriction Has Not Caused Any Loss In Welfare.. 30

B. The Network Restriction Should Be Retained Because The Networks Are Able Effectively To Dictate Affiliate Program Choices 32

C. The Networks Should Not Be Allowed To Syndicate Programs In The Access Hour Because To Do So Would Vitiate The Network Restriction 35

CONCLUSION 36

EXHIBIT A Coalition Membership List

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To: The Commission

REPLY COMMENTS OF
THE COALITION TO ENHANCE DIVERSITY

The Coalition to Enhance Diversity (the "Coalition"), on its own behalf and on behalf of its members, hereby submits these reply comments in the above referenced proceeding.[1]

SUMMARY AND INTRODUCTION

While the initial comments submitted in this proceeding evidence disagreement among the interested parties on a number of issues, they reflect a consensus that the Commission must use principles of cost/benefit analysis in deciding whether to preserve, modify or eliminate the Prime Time Access Rule ("PTAR" or the "Rule"). When these principles are properly applied, they lead inescapably to the conclusion that the public interest will be served by (1) immediate repeal of the Rule's off-network restriction and (2) preservation, at least for the time being, of the Rule's network restriction. As

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1 A complete list of the Coalition members is set forth at Exhibit A.

demonstrated in our initial comments, the purposes of the off-network restriction have been achieved, and its perpetuation serves only to harm the viewing public by creating perverse incentives for program investment. The network restriction, in contrast, plainly continues to contribute to the diversity of programming available and has no demonstrable costs that outweigh this benefit.

There is no dispute that the off-network restriction has sheltered the first-run syndication and independent television businesses from the competitive buffets of the free marketplace. Proponents of the restriction argue in favor of its retention principally on the ground that removing this shelter will impose some economic hardship on individual syndication companies and independent television stations. As we demonstrate below, these arguments rest on false premises and flawed empirical analyses.

The case for retention of the off-network restriction, as articulated by its proponents, is based on the assumption that absent the restriction, network affiliates in the Top 50 markets will purchase popular off-network programming that was previously purchased by independent stations, resulting in an immediate drop in the ratings and earnings of independent stations. As demonstrated in these reply comments, the evidence proffered to support this hypothesis is internally inconsistent, as is the argument itself. For example, the prediction is flatly inconsistent with the fact that the ratings of first-run programs are generally higher than those of off-network programs -- a fact that the restriction's proponents and their economic consultants, LECG, expressly concede.

Close examination of the empirical work performed by LECG reveals why their results are inconsistent with their own predictive judgments as well as marketplace realities.

As the reply comments of Professors Williamson and Woroch demonstrate in detail, the LECG report is so replete with data problems, modeling errors, and flawed interpretation of their statistical results that it does not provide any evidence on which the Commission may properly rely in reaching a reasoned decision in this matter.[2]

The justifications advanced by the proponents of the off-network restriction suffer from a more fundamental weakness, however: they require the Commission to embrace a regulatory philosophy that holds that regulatory protection, once it has been extended to a segment of an industry, may never be withdrawn. But when the Commission adopted the off-network restriction, it expressly rejected the view that its purpose was "to carve out a competition-free haven" for certain participants in the broadcast industry.[3] There is no reason for the Commission to change course and accept that view today.

Unlike the off-network restriction, the network restriction continues to serve the public interest in broadcast diversity by ensuring that affiliates of the established networks have the ability to program one of the four prime time evening hours. The networks' economic consultants claim that eliminating the networks' ability to program the access hour has resulted in less expensive, lower quality (and thus less popular) programming being aired during this hour, to the detriment of the viewing public. Of course, if this were so, one would expect to see the network affiliates united with the networks in favor of repeal of the network restriction,

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2 Reply Comments of Oliver E. Williamson and Glenn A. Woroch at 21-39 ("Williamson & Woroch Reply").

3 *Amendment of Part 13 of the Commission's Rules and Regulations With Respect to Competition and Responsibility in Network Television Broadcasting,* 23 FCC 2d 382, 397 (1970) ("*1970 Report and Order*").

urging the Commission to allow the networks to program the access hour with more attractive fare.

The network affiliates, however, stand squarely against repeal of the network restriction. And the networks themselves make no claim that they will broadcast programming during the access hour in the event that the network restriction is repealed. Indeed, CBS expressly disclaims any such intent. When economic theories, such as those advanced by the networks' economists here, fail so completely in explaining the actual behavior of the economic actors to which they purportedly apply, the inescapable conclusion is that those theories are not sufficiently refined to capture accurately the complex workings of the marketplace.

In their comments, Professors Williamson and Woroch have offered an alternative analysis of the network restriction that explicitly accounts for the contractual complexities inherent in the network-affiliate relationship. This analysis, which is consistent with the positions of the affected parties, supports the conclusion that the network restriction continues to serve the public interest in program diversity.

If, as the networks suggest in their comments, they would not program the access hour in the event that the network restriction is repealed, then there is no cost (but considerable benefit) to preserving the restriction. If, on the other hand, the networks would elect to distribute programming during the hour, via either the front door of a network feed or the back-door of first-run syndication, then the diversity benefits of the network restriction would be lost. As we demonstrate below, these costs would not be outweighed by any gains. Accordingly, while the off-network restriction should be eliminated expeditiously, the network restriction should be retained until further developments in the broadcast marketplace ensure that its repeal will not harm program diversity.

I. PROPONENTS OF THE OFF-NETWORK RESTRICTION HAVE FAILED TO MAKE A CASE FOR ITS RETENTION

A. Elimination Of The Off-Network Restriction Will Not Produce The Dire Consequences Predicted By Supporters Of The Restriction

In its comments, INTV claims that "independent television service would deteriorate materially if the . . . off-network restriction were repealed."[4] King World and Viacom make similar assertions,[5] and the Media Access Project goes so far as to predict that "[a]ll but a few of the most powerful independents will go dark."[6] As explained below, there is no credible evidence to support these dire predictions.

1. The Market For First-Run Programming Will Not Be Destroyed When The Off-Network Restriction Is Lifted

Proponents of the off-network restriction claim that first-run syndicated programming cannot survive absent government regulation because of the high cost of producing such programming. This claim is inaccurate. It also overlooks the fact that first-run programming has a number of advantages over off-network programming, including higher ratings. This is why, in situations where first-run programming competes directly with off-network programming today, first-run programming typically prevails.

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4 INTV Comments at 40.

5 *See* King World Comments at 2-3; Viacom Comments at 15.

6 Media Access Project Comments at 16.

a. First-Run Syndicated Programming Does Not Have Any Unique Cost Disadvantage When Compared To Off-Network Programming

INTV, Viacom, and King World all argue that syndicators of first-run programming have insurmountable cost disadvantages that would prevent them from competing effectively against off-network syndicators in the absence of PTAR's off-network restriction. This is simply untrue.

First, as Professors Williamson and Woroch explain, this argument rests on a simplistic and static view of program pricing.[7] A proper economic analysis demonstrates that there is no support for LECG's conclusion that syndicators of first-run programming would not be able to compete successfully with syndicators of off-network programming once the off-network restriction is repealed.[8]

Second, even under the static analysis employed by the proponents of the off-network restriction, first-run programming does not face an insurmountable cost disadvantage. The proponents of the off-network restriction err in their analysis because the cost comparison prepared by LECG at the behest of INTV, Viacom and King World accounts for only a portion of the costs that off-network syndicators face. It simply ignores, for example, residual payments and royalty costs that must be made when an off-network show is successfully syndicated. Yet these payments typically range from \$50,000 to \$60,000 per episode for half-

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7 Williamson & Woroch Reply at 12-16.

8 *Id.* at 12-16. Indeed, if the simplistic and static analysis advanced by proponents of the off-network restriction were valid, "one would expect to find many markets that experience a dearth of new product introductions because they cannot compete with used versions of similar products." *Id.* Yet, as Professors Williamson and Woroch explain using the example of book publishing, new products are introduced into such markets all the time. *Id.* at 16.

hour shows during the first syndication cycle. For 100 to 175 episodes, therefore, these costs may total as much as $6 to $10 million. More significantly, LECG's cost comparison fails to consider unrecovered production deficits, costs of failed pilots and failed series,[9] development spending write-offs, and guaranteed advances to talent, which off-network syndicators must recover in order to remain in the marketplace in the long run. When these costs are included, the costs incurred by off-network syndicators can run tens of millions of dollars per year, leaving them with no appreciable cost advantage over syndicators of first-run shows.

LECG's purported justification for omitting unrecovered production costs is that these are sunk costs that are not accounted for in the pricing decisions of off-network syndicators. While an off-network syndicator might be able to ignore these costs in the short run for one particular program, it cannot ignore them in the long run or in its overall business decisionmaking. Indeed, failure to cover these costs in the long run would eventually end in bankruptcy. Consequently, the proper focus for any analysis of costs is on all of the costs associated with an off-network syndicated program, from unrecovered production costs to distribution costs, for these are the costs that syndicators must consider in making their long-run investment decisions.[10]

Marketplace evidence confirms the flaws in LECG's economic reasoning. Three types of evidence are probative of this point. First, if LECG's analysis is correct, one would

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9 LECG simply ignores the costs involved in developing and producing shows that never reach off-network syndication. Yet, as explained in the Coalition's Comments, the revenues earned in off-network syndication must cover the costs of those unsuccessful shows as well. *See* Coalition Comments at 10. In addition, while launch costs are not as high as for new first-run programs, syndicators typically spend at least $3 million to promote shows entering the off-network market.

10 Williamson and Woroch Reply at 15-16.

expect that first-run syndicators would sell few, if any, shows in markets where they are not protected by the off-network restriction today, *i.e.*, in markets below the Top 50. First-run syndicated programming, however, makes up 76 percent of all syndicated programming aired in the access hour by network affiliates in markets 51-100.[11] This evidence demonstrates that first-run syndicated programs are very popular and, further, that any "cost disadvantage" they have does not prevent them from competing successfully against off-network shows in a world without the protection of the off-network restriction.[12]

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11 Nielsen Station Index, Nov. 1994.

12 Viacom attempts to dismiss this evidence by simply asserting that first-run syndicators are able to price more "competitively" in markets 51-100 because they earn a substantial portion of their revenues in the Top 50 markets. Viacom Comments at 32. Yet Viacom fails to provide any substantiation for this claim, much less evidence that first-run syndicators are pricing below cost in these markets. If they are pricing above cost, as our analysis above demonstrates, then they are simply competing (quite successfully) on the merits. This is the type of competitive dynamic that will occur in the Top 50 markets once the off-network restriction is eliminated.

Relying on the LECG report, King World also attempts to disparage the evidence concerning markets 51-100 by arguing that network affiliate purchases in markets 51-100 reveal nothing about the programming choices that affiliates in the Top 50 markets would make in the absence of the off-network restriction because stations in markets 51-100 are dependent upon purchases in the Top 50 markets. King World Comments at 10. LECG asserts that is because first-run programs are more risky in that they "have the potential for higher ratings than off-network programs but they also have the potential for lower ratings." LECG Report at 60. LECG then claims that "the decision to air a first-run syndicated program in the Top 50 markets *makes the choice of this program by an affiliate in a smaller market less risky* since the Top 50 market sales establish nationwide viability." *Id.* From this analysis, LECG then concludes that stations in the Top 50 markets will not purchase first-run programming once the off-network restriction is repealed. *Id.*

LECG's reasoning is faulty in two respects. First, the risk that LECG is describing -- *i.e.,* the risk that a new first-run show will fail to garner ratings in a particular *market* -- is completely independent of how many stations buy that show. A new first-run program may be wildly successful in New York, but fail miserably in Peoria. The simple fact that affiliates in the Top 50 markets buy a first-run program, therefore, does *not* "make the choice of this program by an affiliate in a smaller market less risky" from a ratings standpoint. Second, affiliates in markets 51-100 are free to buy whatever programs that they think will be most successful in the access period. If LECG were correct in saying that first-run programs are so much more expensive and risky than off-network shows that no affiliates in the Top 50 markets would buy them once the off-network restriction is removed, then one would expect to see the affiliates in markets 51-100 behaving in precisely this way. Yet the evidence shows that these stations overwhelmingly purchase first-run syndicated programming. LECG offers no
(Footnote 12 Continued)

Second, very recent experiences in the Top 50 markets confirm the competitive viability of first-run programming. As discussed in the Coalition's Comments, some of CapCities/ABC's owned stations have recently reaffirmed their commitment to first-run syndicated programming by agreeing to license the first-run programs *Wheel of Fortune* and *Jeopardy* until the year 2000.[13] In addition, CBS-owned stations in New York, Los Angeles, and Chicago have renewed *Entertainment Tonight* through the year 1999 for access.[14] These long-run commitments were made even though CapCities/ABC and CBS were aware that the off-network restriction might be eliminated.[15] Moreover, in Phoenix, WB affiliate KTVK (formerly an ABC affiliate) recently selected *Wheel of Fortune* and *Jeopardy* over off-network fare for use in prime time.[16]

Third, the performance of off-Fox shows (which are not subject to the off-network restriction) also demonstrates that first-run syndicated programming can effectively compete against off-network programs. For example, only four of the stations in the Top 50 markets that purchased the successful off-Fox show *Married . . . With Children*

(Footnote 12 Continued)
persuasive reason to believe that stations in the top markets will not continue to buy this programming once the off-network restriction is removed. (We note, in this regard, that King World is incorrect when it asserts that "clearance in the Top 50 markets is a *prerequisite* to clearance in markets 51-100" (King World Comments at 10); in fact, a syndicated program needs to obtain clearances in at least *five or six* of the ten largest markets in order to be successfully syndicated.)

13 Coalition Comments at 14.

14 Jim Benson, *CBS O&O Trio Tie Up Par Duo Daily,* Variety, Feb. 17, 1995 at 7.

15 Indeed, CBS made its purchase even after the Commission had issued its NPRM.

16 Michael Freeman, *Shuffled Stations Swap Shows*, Mediaweek, Aug. 1, 1994 at 8.

were ABC, CBS or NBC affiliates. In total, only 13 stations in the Top 50 markets selected off-Fox shows.[17]

Finally, even if LECG were correct in its assertion that syndicators of first-run programming bear some relative cost disadvantage, this would mean only that, when faced with competition from off-network syndicators, first-run syndicators might have to incur somewhat larger deficits in the first year or so of production. Because new first-run programs are typically licensed for only one year, first-run syndicators can and do increase the prices for their successful shows in their second year. For example, the syndicator of *Ricki Lake* was able to double, or in some instances triple, the license fees for that show in its second year.[18] Substantial increases in license fees that successful first-run syndicated shows command in subsequent years, and the corresponding margins that first-run syndicators earn on these programs, will more than offset any conceivable cost disadvantage that a first-run syndicator might incur in the first year of production.

b. First-Run Syndicated Programming Has Many Advantages Over Off-Network Programming

While King World, Viacom and INTV trumpet the supposed cost disadvantage faced by syndicators of first-run programming, they are noticeably silent when it comes to the advantages that first-run syndicated programming offers stations. Those advantages, however, cannot be ignored. First, first-run syndicated programming produces results. For example, according to LECG, in November 1993 for markets 51-60, the average rating for first-run

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17 Coalition Comments at Figure 8.

18 Steve Brennan, *Talk isn't cheap: 'Ricki' renewal fees soaring,* The Hollywood Reporter, Dec. 22, 1994 at 1.

programs was 12.4, compared to only 7.2 for off-network programs.[19] This average rating is *4 points higher* than the rating level that LECG says a first-run program needs to "compete in the long-run with off-network programs."[20] Indeed, these ratings allow stations airing first-run syndicated programming generally to command higher advertising rates.[21]

In addition, Viacom cogently explains why broadcasting highly rated programs during the access period is critical to a station's (particularly an independent station's) success. Viacom says that it is important for a station to attract a large number of viewers during the access hour in order to maximize its "audience flow" -- *i.e.,* the number of viewers who will then watch some (or all) of the station's offerings during prime time. The reason for this audience flow, according to Viacom, "is *not* because it is difficult to switch to another channel, but because that audience provides the [station] with an exceptional opportunity to promote the [rest of the station's] schedule."[22] In other words, higher ratings during the access hour will translate into higher ratings during prime time. Consequently, even assuming that broadcasting a cheaper, lower-rated off-network program during the access hour would generate somewhat greater profits during this period (as the proponents of the off-network restriction (including Viacom) claim), stations will weigh this gain against the potentially far greater economic benefit that higher-rated first-run programming confers by providing larger

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19 LECG Report at 84. In addition, according to INTV, in markets 1-100 first-run syndicated programming on VHF affiliates in the access period in November 1993 had an average rating of 12.0 versus an average of 8.7 for off-network programs. INTV Comments at 68 n.116.

20 LECG Report at 81.

21 *See, e.g.,* Scotty Dupree, *What The Stations Take,* Mediaweek, Jan. 23, 1995 at 36-39.

22 Viacom Comments at 23-26. This also is an important time period to promote lucrative local news programs and programming in other key dayparts.

audiences for the entire prime time period. It is no surprise, therefore, that INTV's informal survey of independent stations reports that 71 percent of them would "substitute level 'A' first-run for 'A' level off-network programming."[23]

The ratings of first-run syndicated programming and their concomitant benefits are not the only advantage of this type of programming. First-run programming is not as financially risky for stations. Licenses for off-network programs typically last between five and seven years.[24] Stations purchasing off-network programming must pay license fees during that entire period whether they air the show or not.[25] On the other hand, commitments to new first-run syndicated programs are typically for only one year.[26] Thus, stations can drop an unsuccessful first-run syndicated show without as large a financial loss as would be incurred with an off-network program.[27]

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23 INTV Comments at Exhibit 7, p. 3.

24 *See* LECG Report at 76.

25 These expensive long-term commitments, in combination with the off-network restriction, have created serious difficulties for many former independent stations that have become network affiliates. For example, ABC affiliate KNXV in Phoenix and CBS affiliate WGNX in Atlanta purchased *Home Improvement* for broadcast in the access period while they were still a Fox affiliate and an independent station, respectively. With their recent network affiliations, KNXV and WGNX are precluded from airing the show in the access period, the only period which has a large enough potential audience to allow them to recover the price they paid for the program.

26 LECG Report at 76. In a rare case, the commitment to a new first-run syndicated show might be for two years.

27 The effects of being locked into long term contracts for off-network programs that do not perform up to expectation in syndication can be devastating for stations. A recent example is the *Cosby Show.* Stations paid an average fee of over $4 million *per episode* to acquire the off-network syndication rights for the program. John Lippman, *Too Costly for Prime Time,* Los Angeles Times, Mar. 22, 1992 at D1, D8. When it failed to garner the expected ratings in syndication, the program "wound up financially crippling many stations." Rita Koselka, *He was an Octopus . . .* , Forbes, Oct. 26, 1992 at 192, 194. The poor syndication performance of the *Cosby Show* was not an isolated incident. Other network hits such as *All In The Family, Taxi, Mary Tyler Moore, Designing Women* and *Murphy Brown* have also performed poorly in syndication.

First-run programming also gives stations greater flexibility to respond to changes in viewers' tastes. At the 1995 NATPE Convention, nearly 100 new first-run syndicated shows were offered for sale for airing in the 1995 television season. In contrast, only five new off-network sitcoms had been offered for airing in the same season. In addition, stations must buy off-network shows two years before they will air, whereas first-run syndicated programming is purchased only a year before it airs. First-run programming thus offers a wider variety of recently created shows from which stations may choose to meet often changing viewer preferences.

Finally, first-run syndicated programs have the advantage of always being new. Off-network shows are, in contrast, repeats. As a result, an off-network show is commonly moved after approximately three years in access to another time slot because audiences grow tired of the show and it can no longer command sufficient ratings to justify continuation in the access period.[28] The station then has to find a replacement show.[29] It is because of these myriad advantages that affiliates in markets 51-100 choose first-run syndicated programming more than two-thirds of the time over off-network programming. This is also why television stations (ABC, CBS and NBC affiliates, as well as independent stations) will continue to demand first-run syndicated programming for the access period once the off-network restriction is eliminated.

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28 For example, in Chicago, NBC-owned WMAQ dropped the off-Fox *Married . . . With Children* in favor of first-run syndicated *Extra* in the access period. Joe Flint, *WB gets Extra' play in Chi,* Daily Variety, Feb. 16, 1995 at 23. WMAQ took this action after it had aired the show for three seasons in access. Nielsen Station Index, Sept. 91 - Feb. 95.

29 The off-network hit *Golden Girls*, for example, enjoyed a 42 percent access clearance level its first year in syndication. By year three, that level had dropped to 24 percent. By year four, only 11 percent of the program's clearances were in access. Similarly, access clearance levels for *Who's The Boss* fell from 52 percent in year one to 27 percent in year three. Nielsen Station Index, Nov. 89-93.

c. Because The Cost Structure Of First-Run Syndicators Is A Product Of The Protections Of The Off-Network Restriction, First-Run Syndicators Will Simply Adjust Their Costs To Account For Competition

The overriding concern of first-run syndicators such as King World and Viacom is how their pocketbooks will be affected by the increased competition that will result from removal of the off-network restriction. As Professors Williamson and Woroch explain in their reply comments, however, increased competition will result in the more efficient production of television programs of equal or higher quality.[30] While some marginal and inefficient firms may be lost, efficient firms will take their place and the public welfare will be enhanced.[31]

INTV and the Media Access Project, in contrast, argue that first-run syndicators should remain protected from competition with off-network syndicators because of their purportedly higher costs. Even if the costs faced by first-run syndicators were higher,[32] however, there is no reason to believe that this cost structure would persist if the off-network restriction were eliminated. The current cost structure is a product of the protected environment in which first-run syndicators currently operate. In the absence of the off-network restriction, they will adjust to increased competition by lowering costs and increasing their efficiency.[33]

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30 Williamson & Woroch Reply at 11.

31 *Id.*

32 *See* INTV Comments at 52, Media Access Project Comments at 15. First-run syndicators, in fact, do not suffer from any cost disadvantages vis-a-vis off-network syndicators. *See* pp. 6-10, *supra*.

33 *See* Harvey Leibstein, *Allocative Efficiency vs. "X-Efficiency,"* 56 American Economic Review 392, 408-09 (1966).

Recent economic history is replete with examples of how competition can force companies to cut costs and at the same time produce higher quality products. AT&T, for example, when forced to compete, cut costs and produced products of greater quality at lower prices. The three largest domestic automobile manufacturers have also cut costs and improved quality in the face of overseas competition. Just as these companies have managed to adjust to competition, first-run syndicators can -- and will -- also make the adjustment.

2. First-Run Syndicated Programming Is Not Handicapped By Any Flaws In The Market

The proponents of the off-network restriction also seek to justify the off-network restriction on the grounds that it corrects a fundamental flaw in the television programming and advertising markets. They argue that these markets are "public goods" markets that will not produce the optimal amount of television programming and advertising in the absence of regulation. Neither television programming nor television advertising markets suffer from any market flaw, however, public good or otherwise. Moreover, the off-network restriction, now approaching its silver anniversary, can no longer be sustained on infant industry grounds.

a. First-Run Syndicated Programming Is Not A Public Good

A linchpin of LECG's argument in support of the off-network restriction is the notion that this restriction is necessary "as a corrective for a failure in a public goods market, namely the market for syndicated programming."[34] LECG never explains, however, why syndicated programming is properly classified as a public good. Nor does it explain how PTAR operates to solve a public good problem. That is because there simply is no rational explanation. As Professors Williamson and Woroch demonstrate, LECG's argument rests on a

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34 LECG Report at 4.

fundamental misunderstanding of the economics of public goods -- a misunderstanding that leads LECG to recommend a policy prescription (PTAR) that could serve only to exacerbate the public good problem they purport to identify.[35]

b. The Actual Production Costs For First-Run Syndicated Programs Are Not Unique And Do Not Require Regulation

While it is clear that syndicated programming is not a public good, the question remains whether the cost characteristics of television programming identified by LECG are so unique that they justify retention of the off-network restriction. Leaving aside for the moment the issue of the validity of LECG's assumptions, these characteristics provide no basis for retaining the off-network restriction. LECG draws support for its argument from a chapter in *Video Economics*, by Owen and Wildman,[36] which suggests that the television programming industry is characterized by high fixed costs and low marginal costs. According to Owen and Wildman, however, these cost characteristics apply to *all* television programming, not just syndicated programming (or first-run syndicated programming).[37] Why, then, is the off-network restriction -- which protects only first-run programming -- an appropriate regulatory solution? If the cost characteristics of television program production warrant government protection of the industry, then that protection should extend to *all* types of programming. LECG never explains, becuase it cannot explain, how the off-network restriction corrects the "market failure" it purports to identify.

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35 Williamson and Woroch Reply at 8-11.

36 LECG Report at 8.

37 Bruce M. Owen & Steven S. Wildman, *Video Economics* 24 (1992).

In fact, the actual cost characteristics of television programming do not justify regulation in the form of the off-network restriction. First, the marginal cost of producing television shows are not, as LECG argues, relatively low. LECG itself argues that the average annual production cost (which is a large, but not the sole, component of the marginal cost) for first-run programs targeted for the access period was $17.7 million in 1994.[38] Second, many industries are characterized by high fixed costs and low marginal costs, but few of them are regulated. LECG, in short, offers no rational economic basis for the Commission to conclude that the costs characteristics of the syndicated programming industry warrant perpetual protection for producers of first-run shows.

c. The First-Run Syndication Industry Does Not Require Or Warrant Continued Infant Industry Protections

At most, the cost characteristics of first-run program production justified limited protection for syndicators under an infant industry rationale. Under this rationale, first-run syndicators should be protected as they enter the market to allow them to establish themselves and compete with the more established off-network syndicators. However, as Professors Williamson and Woroch explain in their comments, once these firms are established, they lose their entitlement to protection; if efficiency gains from increased competition are to be realized, these firms must learn to adapt and survive on their own.[39]

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38 LECG Report at 71. The marginal costs of producing any television program (first-run syndicated or otherwise) are much greater than the marginal costs of production in industries that are characterized by low marginal costs, such as the telephone industry. In the telephone industry, for example, the marginal cost of adding an additional customer to the network is negligible.

39 *See* Oliver E. Williamson and Glenn A. Woroch, *A Comparative Efficiency Analysis of the FCC's Prime Time Access Rule,* filed March 7, 1995, at 20-21 ("Williamson & Woroch Comments").

King World, Viacom, and INTV concede (as they must) that producers of first-run syndicated programming are very successful today. In the words of INTV, the first-run syndication industry is "vibrant" and the top syndicators have "enjoyed considerable success."[40] They are frankly acknowledging that they have overcome the burden of establishing themselves in the previously nascent first-run syndication industry. This means that the time has come to end the special protections that first-run syndicators have enjoyed for the last 25 years. As the Commission stated in 1970 when it promulgated PTAR, the purpose of the rule was not "to carve out a competition-free haven for syndicators"; rather, the purpose was to "provide opportunity . . . for the competitive development of alternate sources of television programs . . . ."[41] The first-run industry is now here and successful, and the justification for the off-network restriction -- if it ever existed -- has expired.

3. Independent Stations Will Not Suffer Serious Financial Harm If The Off-Network Restriction Is Lifted

INTV alleges that independent television service will also deteriorate if the off-network restriction is eliminated in part because "the financial position of independent television stations [will] deteriorate."[42] INTV proffers two reasons why independent stations may lose money if the off-network restriction is eliminated, neither of which justifies continued regulation. Moreover, even if one assumes that independent stations will choose to pay more for certain programs, the financial harm that INTV describes will not have a serious impact on the majority of independent stations.

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40 INTV Comments at 34.

41 *1970 Report and Order* at 397.

42 INTV Comments at 41.

a. Independent Stations Will Not Necessarily Pay More For Programming

There is no question that the restoration of competition that will result from removal of the off-network restriction will affect the relative prices of off-network and first-run syndicated programming. While the price of some off-network programming may rise, the price of some first-run programming may fall. In response, some independent stations may *choose* to pay higher prices for certain off-network programs. Others, however, may choose to purchase higher-rated first-run programming at a lower price. In fact, for the reasons discussed above, independent stations may well find competitively priced first-run programming more attractive than off-network programming. This is why 71 percent of the respondents to INTV's informal survey said they would purchase "A" level first-run shows in place of "A" level off-network shows.[43]

The fact that some independent stations may choose to continue purchasing off-network hits and, as a consequence, may pay more for programming does not justify continuation of the off-network restriction. After enjoying 25 years of artificially restrained prices, the time has long since come for independent stations to pay *competitive* prices for programming they desire.[44] There is no public policy rationale for providing continuing support to the mature independent television industry.

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43 *Id.* at Exhibit 7, p. 3.

44 Williamson & Woroch Comments at 19-20.

b. Independent Stations Will Not Necessarily Lose Access To Top Quality Off-Network Programs

INTV asserts that independent stations would suffer financially if the off-network restriction were eliminated because they would "los[e] . . . access to top tier off-network programming."[45] According to INTV, network affiliates will substitute off-network programming for first-run programming once the off-network restriction is eliminated because "affiliates would make more money showing off-network programming in access time."[46] The evidence, however, does not support this assertion.

If it were true that affiliates find it more profitable to air off-network programming in the access period, then one would expect that network affiliates in markets below the Top 50 would uniformly broadcast off-network programming during that time period. Clearly, however, they do not. As noted above, first-run programs constitute 76 percent of the syndicated programs broadcast by network affiliates in markets 51-100 during the access hour.[47]

INTV's own statements and evidence, moreover, disprove its claim that network affiliates would always select -- and would always be able to outbid independent stations for -- off-network programming for the access period. First, INTV acknowledges that a first-run program can be more profitable than an off-network program in the access period if it earns higher ratings.[48] Second, INTV concedes that first-run programs in fact often earn higher

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45 INTV Comments at 51. Viacom makes this same assertion. *See* Viacom Comments at 5.

46 INTV Comments at 49. According to INTV, this is because, as between an off-network program and a first-run program with the same ratings, the off-network program is less expensive for the station due to differences in barter splits.

47 Nielsen Station Index, Nov. 1994.

48 INTV Comments at 49-50 ("[F]irst-run programs must draw larger audiences if they are to offer stations financial terms attractive enough to be competitive with off-network programs.").

ratings than even successful off-network programs. Indeed, INTV states that "off-network programming, although the cream of the crop, likely would attract smaller audiences than the first-run programming it would replace."[49] What INTV fails to acknowledge is the critical point that Viacom makes in its comments: high ratings in the access period are the key to higher ratings in prime time. Thus, while broadcast of a lower-rated off-network show in the access hour may result in higher profits *in that hour,* broadcast of a higher-rated first-run show is likely to result in higher profits for the entire prime time period. INTV's assertion that profit maximizing network affiliates would, if given the opportunity, always replace first-run programming with top quality off-network programming is therefore illogical.[50]

INTV's evidence also reveals that in 1993, two of the top five off-network programs broadcast in markets 51-100 were aired more often on independent stations than on affiliates.[51] If INTV's assertion that affiliates will always outbid independent stations for top quality off-network programs were true, one would expect that all five of these off-network hits would have aired more frequently on affiliates. One of the principal reasons why many stations, including many affiliates, in these markets choose to air first-run programming during the access period, while others air off-network programming, is that there is a competitive

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49 *Id.* at 68. INTV notes: "[O]ff-network programming on VHF affiliates had an average rating of 8.7 versus a 12.0 rating for first-run programs. Similarly, off-network programming on UHF affiliates had an average rating of 5.2 versus a 9.6 rating for first-run programs." *Id.* at n.116.

50 This is especially so given the huge financial investment a station makes when it acquires an off-network hit. As discussed above, *supra* at 12, successful network programs are sold in syndication on a long-term basis. A station that purchases a network hit in syndication therefore takes the chance that it will not be able to recoup over the license term the high costs associated with acquiring the program. As evidenced by the *Cosby Show,* the result of the gamble can be financially devastating. *See supra* at 12 n.27.

51 INTV Comments at 46.

advantage to "counter-programming." This is why it is highly unlikely that network affiliates in the Top 50 markets will shift *en masse* to off-network programming when the off-network restriction is lifted. This is also why it is absurd to argue, as some of the proponents of the off-network restriction do, that *no* station will find it profitable to purchase first-run programming for the access hour once the restriction is eliminated.

In any event, even assuming that network affiliates in the Top 50 markets would always select off-network programming and would always be able to outbid independent stations for such programming, INTV's evidence demonstrates that independent stations would still be able to purchase off-network programs. For example, INTV's 1993 data reveals that five off-network programs became available that year. Hence, even if the ABC, CBS and NBC affiliate in any given market each purchased an off-network hit, there still would be two off-network hits for the other stations in the market to purchase.[52] Thus, the claim that independent stations would somehow be deprived of off-network programming if the off-network restriction is lifted is wholly unsupported.[53]

c. Even Assuming That Independent Stations Were Outbid For High Quality Off-Network Programs, Their Financial Loss Would Not Be Significant

For the reasons explained above, elimination of the off-network restriction will not result in independent stations being consistently outbid for top quality off-network

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52 *See id.* Using INTV's 1992 data, there would have been three off-network hits left for independent stations to purchase. *See id.*

53 Viacom's assertion that "Disney and other off-network syndicators undoubtedly expect this result or they would not be fighting so hard for repeal," Viacom Comments at 22, is particularly ludicrous. Disney and others are seeking elimination of the off-network restriction in order to ensure a competitive marketplace for off-network programs.